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No. 80-582

In the Supreme Court of the United States

OCTOBER TERM, 1980

J. M. ZACHARY, ET AL., PETITIONERS

v.

FEDERAL ENERGY REGULATORY COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether the Federal Energy Regulatory Commission has jurisdiction to interpret contracts involving producer sales of natural gas in interstate commerce in order to determine the appropriate rate for such sales under the Commission's pricing regulations.

2. Whether the Commission properly characterized the gas contract in this case as a currently effective "life-of-lease" contract, thereby disqualifying petitioners from recovering a higher, replacement contract rate.

3. Whether petitioners were denied due process when the Commission interpreted the relevant contract provisions without granting petitioners an evidentiary hearing or an opportunity to present oral argument.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. i-xiii) is reported at 621 F.2d 155. The orders of the Federal Power Commisison and its successor, the Federal Energy Regulatory Commission (Pet. App. xiv-xviii, xix-xxxi), are not reported.

JURISDICTION

The judgment of the court of appeals was entered on July 9, 1980. The petition for a writ of certiorari was filed on October 7, 1980. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTES INVOLVED

Sections 4(e) and 5 of the Natural Gas Act, 15 U.S.C. 717c(e) and 717d, are reprinted in Pet. App. xxxiv-xxxvi.

STATEMENT

1. Petitioners sell natural gas to Northern Natural Gas Company, an interstate pipeline company, for resale in interstate commerce. The sales are subject to the jurisdiction of the Federal Energy Regulatory Commission under Section 1(b) of the Natural Gas Act, 15 U.S.C. 717(b). The gas purchase agreement involved in this case was executed in 1954 by a seller and buyer to whom petitioners, as working-interest owners, and Northern, as buyer, are successors in interest.

In 1973, the Commission established the so-called "replacement contract" policy as a feature of its regulation of the rates charged by producers of natural gas. Before this policy, the Commission set the rate

for producers' sales of gas according to a pricing method known as "vintaging." As the court of appeals explained in an earlier case,

> [v]intaging by contract is the practice of pricing gas according to the date when the contract for its production was signed. Area rate orders have used contract vintaging in establishing a two-tiered rate structure. All gas produced under contracts signed before a certain date [the so-called "division date"] is pegged at one price, while the gas produced under later contracts gets a higher price.

Shell Oil Company v. *FPC*, 491 F.2d 82, 84 n.5 (5th Cir. 1974). The critical aspect of the vintaging pricing method, as applied by the Commisison, is not immediately apparent from this description of the method or from the Commission's own description. See, *e.g.*, 24 F.P.C. 818 (1960). In practice, vintaging meant that gas produced by and entering interstate commerce from fields whose production was, at one time, sold under a contract signed before the division date remained "old" gas (*i.e.*, gas priced at "old"-gas rates), even when the predivision date contract expired and a new, post-division date contract was signed for the purchase of such gas.

In establishing the replacement contract policy, the Commission sought gradually to eliminate "vintaging." The new pricing practice means that gas produced and sold under contracts signed on or after the division date, January 1, 1973, may be defined as "new" gas (*i.e.*, gas priced at "new"-gas rates), even if the gas is produced by fields that once supplied pre-1973 contracts. In order for gas produced by such fields to qualify for "new"-gas treatment, the post-1973 contract must replace an earlier contract

that has expired by its own terms.[1] The issue in this case is whether the 1954 agreement between petitioners and Northern expired by its own terms when petitioners ceased delivering gas to Northern.

The duration of the 1954 agreement is governed by the following contract term (emphasis added):

> Subject to the other provisions hereof, this agreement shall be in force for an original term from its date until the expiration of a twenty (20) year period following the date hereof and *thereafter as long as gas is delivered hereunder in quantities commercial to Seller and Buyer.*

In 1975, more than 20 years after the effective date of the contract, petitioners gave written notice to Northern that they would no longer deliver gas. Petitioners asserted that the contract provision reprinted above permitted them to terminate the contract by simply stopping deliveries and that, having done so, they were free, under the Commission's regulations, to enter into a replacement contract that would qualify for "new"-gas rates.

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[1] The replacement contract policy is currently codified in 18 C.F.R. 2.56a(a)(5), which states that "new" gas rates will apply, provided the sale is made pursuant to

> a replacement contract where the sale was formerly made pursuant to a permanent certificate of unlimited duration under such prior contract which expired by its own term on or after January 1, 1973, or pursuant to a contract executed on or after January 1, 1973, where the prior contract expired by its own terms prior to January 1, 1973.

See *Austral Oil Co.* v. *FPC*, 560 F.2d 1262 (5th Cir. 1977) (sustaining the validity of the replacement contract policy).

Northern, however, did not acquiesce in the termination of the agreement. It took the position that the contract is a "life-of-lease" contract, *i.e.*, one which extends for the life of the commercial production of gas from the fields involved. Petitioners and Northern entered into an interim agreement that allowed petitioners to collect the higher "new"-gas rates subject to refund (R. 39-47).[2] In accordance with this agreement, petitioners sought a declaratory order from the Commission that the original contract had expired by its own terms.

2. On August 2, 1976, the Commission held that the contract is a life-of-lease contract (Pet. App. xiv-xviii). The Commission ruled that the use of the word "delivered" in the disputed contract provision does not mean that Northern is entitled to obtain gas only as long as petitioners are willing to deliver it after the expiration of the initial 20-year period (Pet. App. xvi). Rather, the Commission determined that the succeeding qualifying language, "in quantities commercial to Seller and Buyer," precludes the seller from unilaterally terminating the contract and "requires *both* parties to agree as to whether the quantities are commercial" (*ibid.*) (emphasis in original).

The Commission thereafter reaffirmed its initial order and denied petitioners' application for rehearing (Pet. App. xix-xxxi). The Commission reiterated that the termination provision, viewed in the context of the contract as a whole, "does not confer upon seller an arbitrary termination right" (*id.* at xxii).

3. The court of appeals affirmed in a comprehensive opinion (Pet. App. i-xiii). The court ruled that

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[2] "R." refers to the certified record in the court of appeals.

the Commission properly exercised its jurisdiction to implement the replacement contract policy, notwithstanding the incidental but necessary resolution of an issue of contract interpretation (*id.* at ix-x). The court further held that the Commission's determination that the contract is of unlimited duration, so long as quantities commercial to both parties are deliverable, was reasonable and in accord with the overall intent of the contract (*id.* at iv-viii). Relying on its decision in *Austral Oil* v. *FPC*, 560 F.2d 1262, 1265-1267 (5th Cir. 1977), the court concluded that "denial of the replacement contract rate is here consistent with Commission policy, which has reasonably distinguished contracts of unlimited duration from those having a fixed duration" (Pet. App. ix). Finally, adhering to the established proposition that interpretation of an unambiguous contract term presents only a question of law, the court of appeals rejected petitioners' argument that the Commission erred by failing to conduct an evidentiary hearing or to hear oral argument (Pet. App. x-xii).

ARGUMENT

The decision of the court of appeals correctly applies well-established legal principles to the facts of this case and does not conflict with any decision of this Court or any other court. The subject matter involved—application of the Commission's replacement contract policy to a particular provision in one contract for the sale of natural gas—is not of sufficient importance to merit this Court's attention. Further review is therefore unwarranted.

1. The court of appeals correctly held that the Commission has jurisdiction to determine the proper application of its gas pricing regulations to particular contractual provisions governing the sale of nat-

ural gas in interstate commerce (Pet. App. ix-x). Petitioners themselves implicitly acknowledged this jurisdiction when they sought declaratory relief from the Commission concerning the applicability of the Commission's replacement contract policy to their contractual relationship with Northern. Now, dissatisfied with the Commission's ruling on the matter, petitioners contend that the Commission should never have decided the case in the first place. Contrary to petitioners' argument (Pet. 7-8), however, the Commission's exercise of jurisdiction is fully consistent with established precedent. *United Gas Pipe Line Co.* v. *Memphis Light, Gas & Water Division*, 358 U.S. 103, 114 (1958); *Louisiana Power & Light Co.* v. *FERC*, 587 F.2d 671 (5th Cir. 1979).

The decisions of this Court on which petitioners rely do not support their position. In *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956), this Court held that a utility subject to regulation under the Natural Gas Act could not abrogate its contractual obligation to deliver gas at a fixed price by unilaterally filing for rate increases with the Commission. The Court held only that, in the absence of a Commission finding that the rates specified in a particular contract are contrary to the public interest, contractual rates remain binding, even if the Commission's pricing regulations would permit higher rates. In a later case, this Court held that when a contract allowed the seller to change its rates "from time to time," such a change could become effective upon a unilateral filing with the Commission. The Court specifically stated that "the question whether [the seller's] service agreements reserved to it the power to make rate changes in this manner * * * involves matters peculiarily within the

area of the Commission's special competence * * *." *United Gas Pipe Line Co.* v. *Memphis Light, Gas & Water Division, supra,* 358 U.S. at 114. After *Memphis Light,* no doubt remained regarding the Commission's authority to interpret contractual provisions in order to determine the proper application of its pricing policies in particular circumstances.

Neither *Pan American Petroleum Corp.* v. *Superior Court,* 366 U.S. 656 (1961), nor *City of New Orleans* v. *United Gas Pipe Line Co.,* 390 F. Supp. 861 (E.D. La. 1974), raised any question on this point. Both cases held simply that state courts are not precluded from resolving common law contract claims solely because the contract in controversy is on file with the Commission. Neither case limited the Commission's primary jurisdiction over the application of its rate regulations to particular contracts for the sale of natural gas.

Finally, *Skelly Oil Co.* v. *FPC,* 532 F.2d 177 (10th Cir. 1976) did not even address the matter of jurisdiction. The court of appeals in that case did not question the Commission's authority to decide whether a natural gas contract had expired by its own terms. It merely disagreed with the Commission on the merits of the contract interpretation issue.

2. Petitioners further contend (Pet. 8-9) that the Commission erred in interpreting the contract as a life-of-lease contract, rather than one which expired at the end of a 20-year term.

The court of appeals correctly concluded that the language of the disputed contract provision supports the Commission's finding that the contract is terminable only if the quantities of gas deliverable are noncommercial to the seller or buyer (Pet. App. vii-ix). The court agreed with the Commission that, read in context, the word "delivered" connotes the "normal

flow of gas" from the well rather than the actual amount of gas that the seller chooses to supply to the buyer (*id.* at vii). This interpretation is supported by the inclusion of the phrase "in quantities commercial," which would be superfluous if the seller had a unilateral right to terminate by stopping deliveries (*id.* at vii-viii). In addition, the court, like the Commission, was persuaded by the absence of any contractual provision requiring a notice of termination in the event the seller chooses to cease deliveries and by the inclusion of a provision for rate negotiations after 15 years and at five-year intervals thereafter. Both these features strongly suggest that the contract was intended to be a life-of-lease contract, rather than one terminable at the will of the seller after 20 years.

Petitioners have attempted unsuccessfully to distinguish earlier court of appeals decisions affirming Commission findings that particular natural gas contracts were life-of-lease contracts and therefore precluded sellers from charging higher rates under the replacement contract policy. See *Austral Oil* v. *FPC*, *supra*, and *Superior Oil Co.* v. *FERC*, 569 F.2d 971 (5th Cir.), cert. denied, 439 U.S. 834 (1978). In petitioners' view, the contracts involved in those cases deserved life-of-lease treatment because they did not include a stated primary term. By specifying a 20-year primary term, petitioners argue, their contract with Northern eliminated the life-of-lease possibility and became terminable at the will of the seller after 20 years. The court of appeals rejected this interpretation, however, and correctly observed that "[t]he 20-year term is an assurance that neither party would withdraw from the contract during that period by claiming that quantities delivered were noncommercial" (Pet. App. vi-vii). Petitioners do not now

assert that they are unable to deliver commercial quantities of gas to Northern, and, accordingly, the contract remains in force.

3. Finally, petitioners contend (Pet. 10-11) that the Commission erred in declining to hold an evidentiary hearing or to hear oral argument regarding the meaning of the disputed contract provision. According to petitioners, the contract is "factually ambiguous," and therefore questions as to its meaning cannot be resolved without an evidentiary hearing. This argument is without merit.

The contract interpretation question presented in this case was purely a question of law. As the court of appeals correctly held, the construction of a contract "presents only a question of law unless ambiguity in the contract requires resort to extrinsic evidence of intent" (Pet. App. xi). Notwithstanding disagreement concerning the proper construction of the contract in this case, both petitioners and the Commission agreed that the contract language was unambiguous (*ibid.*). Even now, petitioners have not identified any extrinsic evidence of intent that allegedly would bear on the interpretation of the contract duration provision. In these circumstances, the court of appeals properly ruled that the failure to hold an evidentiary hearing or oral argument did not violate due process. *Vreeland* v. *FPC*, 528 F.2d 1343, 1351 (5th Cir. 1976); *Groendyke Transport, Inc.* v. *Davis*, 406 F.2d 1158, 1162 (5th Cir.), cert. denied, 394 U.S. 1012 (1969). Petitioners do not suggest that they were denied a full and fair opportunity to present their legal arguments in writing, and any such suggestion would be inaccurate.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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